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In the Supreme Court of the United States

OCTOBER TERM, 1968

EDWARD LEE ROBERTS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

RICHARD LEE PLOWDEN AND DALE T. PLOWDEN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

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No. 445

EDWARD LEE ROBERTS, PETITIONER

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Each petitioner[1] owned a 50 percent interest in a corporation. Pursuant to Section 1372 of the Internal Revenue Code of 1954, the corporation elected to be treated as a Subchapter S[2] corporation, whereby electing small business corporations are permitted to dispense with tax at the corporate level and to "pass through" income or losses to their shareholders. In 1963, the corporation sustained a net operating loss, which was passed through to petitioners. At issue is the proper construction of Section 1374(c)(2), which in terms limits the deduction by a shareholder of his portion of the company's net operating loss to the adjusted basis of his stock and the indebtedness of the corporation to him.[3] Below, petitioners urged that they were entitled to utilize their pro rata shares of the loss in full, and, to the extent that such loss could not be employed in 1963, carry back the loss to prior years in accordance with Section 172 of the Internal Revenue Code of 1954.

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[1] These cases were consolidated for hearing in the Tax Court. Because the issue arises entirely out of Richard Lee Plowden's and Edward Lee Roberts' ownership of stock in a corporation, "petitioners" will refer to them. Dale T. Plowden was a party solely because she filed joint returns with her husband, Richard Lee Plowden.

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[2] Sections 1371 through 1378 of the 1954 Code.

[3] Section 1374 reads in pertinent part as follows:

> (a) *General Rule.*—A net operating loss of an electing small business corporation for any taxable year shall be allowed as a deduction from gross income of the shareholders of such corporation in the manner and to the extent set forth in this section.
>
> (b) [as amended by Sec. 2(b), Act of September 23, 1959, P.L. 86-376, 73 Stat. 699] *Allowance of Deduction.*—Each person who is a shareholder of an electing small business corporation at any time during a taxable year of the corporation in which it has a net operating loss shall be allowed as a deduction from gross income, * * * an amount equal to his portion of the corporation's net operating loss (as determined under subsection (c)).
>
> * * * *
>
> (c) *Determination of Shareholder's Portion.*—
>
> * * * *
>
> (2) *Limitation.*—A shareholder's portion of the net operating loss of an electing small business corporation for any taxable year shall not exceed the sum of—
>
> (A) the adjusted basis (determined without regard to any adjustment under section 1376

The courts below correctly concluded (Pet. 11) that the benefits of Sections 172 and 1374 are mutually exclusive and not cumulative. There is no conflict and no occasion for review in this Court.

1. Although Section 172 allows carry backs and carry forwards of operating losses if various specified conditions are met, Section 172(h) expressly provides that for the purposes of Section 172 "the net operating loss deduction * * * of any corporation" shall not include "the net operating loss of such corporation for any taxable year for which such corporation is an electing small business corporation under subchapter S." Section 1374 does provide that, in the case of a

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for the taxable year) of the shareholder's stock in the electing small business corporation, determined as of the close of the taxable year of the corporation (or, in respect of stock sold or otherwise disposed of during such taxable year, as of the day before the day of such sale or other disposition), and

(B) the adjusted basis (determined without regard to any adjustment under section 1376 for the taxable year) of any indebtedness of the corporation to the shareholder, determined as of the close of the taxable year of the corporation (or, if the shareholder is not a shareholder as of the close of such taxable year, as of the close of the last day in such taxable year on which the shareholder was a shareholder in the corporation).

Subchapter S corporation, the shareholders will be permitted to use the loss, but Section 1374(c)(2) expressly provides that a shareholder's portion of the net operating loss shall not exceed his investment in the corporation. The decision below is the only one possible under this statutory format.[4] *Byrne* v. *Commissioner*, 361 F. 2d 939 (C.A. 7), the only other decision in point, is in accord.

2. The court of appeals did not (see Pet. 3) deprive petitioners of due process in dispensing with oral argument in this case, which involves solely the interpretation of a statute that, on its face, is clear and unequivocal in its meaning. See, e.g., *Communications Comm'n* v. *WJR*, 337 U.S. 265, 275-276.

Respectfully submitted.

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[4] Thus, the courts below properly limited the deductions to the petitioners' cost of their stock, plus their share of the corporation's undistributed taxable income, plus, in the case of petitioner Roberts, the amount of $5,000 owed by the corporation to him as of the end of the corporation's taxable year 1963.

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